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24 September, 2012

Securities and Futures Commission  
8<sup>th</sup> Floor, Chater House, 8 Connaught Road  
Central, Hong Kong

By E-mail

Dear Sirs,

**Re: Consultation Paper on the Regulation of Electronic Trading**

We refer to the captioned consultation paper ("**Consultation**") and we write to provide our comments on the Consultation.

ABN AMRO Clearing is a world-leading third-party independent clearer, and has offered Market Access services since electronic trading replaced the trading floors. Our services are extensive and range from access via independent software vendors ("**ISVs**") to client's own trading software via proximity and collocation hosting services for members and non-members alike.

ABN AMRO Clearing Hong Kong Ltd. ("**AACHK**" or "**we**") agrees with the Commission's goals of ensuring the stability and integrity of the financial markets in Hong Kong. As a major provider of market access services, AACHK supports measures that deter market manipulation and provide fair and orderly markets.

In the following response to the Commission's specific questions on Electronic Trading, AACHK would like to make special mention of the following points:

1. We believe that if sufficient pre-trade risk measures are implemented, then there should be no reason to gain access to algorithm source code

as any "rogue" algorithm orders would be picked up by efficient pre-trade risk settings.

2. The Hong Kong Exchanges and Clearing ("HKEx") has the ability to provide certain pre-trade risk controls to the market as a whole. By doing this across the board, they would be being seen to be creating a safer market thus attracting further investment. This must be applied across the board so as to create the same level of access to all investors. By having the HKEx to implement these measures, it means that there should be no opportunity for differences in latency on pre-trade risk management solutions from one market participant to the next.

We set out our responses to the Consultation as follows:

Q1. *Do you agree that the proposed scope of the regulation of electronic trading is appropriate in terms of:*

- (i) *the types of electronic trading, which include internet trading, DMA and algorithmic trading? Yes*
- (ii) *the types of products primarily covered by these proposals namely securities and futures contracts that are listed or traded on an exchange? Yes*
- (iii) *the persons to whom the proposals apply? Yes*

AACHK: The requirements appear to be market wide which creates a "level playing field" for all market participants. We request however, a definition of pre-execution controls required by the intermediaries.

The definition of "Algorithmic Trading" (which is "computer generated trading activities created by a pre-determined set of rules aimed at delivering specific execution outcomes") is very broad and will likely capture relatively simple automated trading "strategies". These types of systems are not normally considered to be "algorithmic trading" systems, therefore further and more specific definition would be required.

Please also note our point 1 above with regards to pre-trade risk settings.

*Q2. Do you agree that an intermediary should be ultimately responsible for the orders sent to the market through its electronic trading system and for the compliance of the orders with applicable regulatory requirements?*

*If not, why not?*

AACHK: Yes, as a provider of electronic trading services, we believe that we have a responsibility to ensure, to the extent reasonably possible, that systems are not being used in a manipulative or disruptive way.

While AACHK carries out strenuous due diligence on its underlying clients, and those clients execute our Standard Client Agreement, which stipulates that the client must adhere to the relevant rules and regulations of the market that client is trading, it would be virtually impossible for AACHK to determine in real-time whether the client is trading with improper intent or negligence.

This being the case, AACHK believes that the wording should be modified to include "to an extent reasonable and practicable with the information available".

*Q3. Do you agree that an intermediary should effectively manage and adequately supervise the design, development, deployment and operation of the electronic trading system it uses or provides to clients for use?*

*If yes, are the proposed requirements sufficient? If not, why not?*

AACHK: While we agree that this requirement can be adhered to for in-house solutions, having this requirement for third-party solutions would be practically impossible for the intermediaries to supervise and manage due to the nature of the third party product.

To cover third party applications, we believe that the underlying client, the intermediary and the HKEx together should bear responsibility for an effective and efficient market. The introduction by the HKEx of market wide pre-trade settings for all participants, and the implementation of more formal conformance process for order management systems are examples of how the HKEx could improve stability.

As Electronic Trading is sophisticated in nature it may be unrealistic to hold an

RO accountable, but rather require the RO or licensed person to assign qualified staff, expertise or technology to effectively manage and supervise the order management system.

*Q4. Do you agree that an intermediary should ensure the integrity of the electronic trading system it uses or provides to clients for use, including the system's reliability, security and capacity, and have appropriate contingency measures in place?*

*If yes, are the proposed requirements sufficient? If not, why not?*

AACHK: AACHK believes that generally, no amount of planning or testing will guarantee the reliability, security or capacity of an electronic trading system and therefore suggests that this be subject to a reasonableness standard.

*Q5. Do you agree that an intermediary should keep, or cause to be kept, proper records on the design, development, deployment and operation of its electronic trading system?*

*If not, why not?*

AACHK: AACHK agrees with the period of record keeping, however AACHK believes that the scope of records to be kept is extremely broad and should be more clearly defined. Additionally, AACHK request the ability to hand over the record keeping requirement to third-parties where the applicable.

*Q6. Do you agree with the proposed periods of record keeping?*

*If not, why not?*

AACHK: Yes.

*Q7. Do you agree that, in providing internet trading or DMA services, the proposed pre-trade controls should be put in place by an intermediary?  
If yes, are the proposed requirements appropriate? If not, why not?*

AACHK: It is AACHK's understanding that these rules are set to enhance the stability and integrity of the market. As such, we would propose to have more

prescriptive pre and post trade controls so as to maintain a level playing field and avoid instability due to differing interpretations of requirements.

*Q8. Do you agree that, in providing internet trading or DMA services, an intermediary should conduct post-trade monitoring to reasonably identify any order instructions and transactions which may be manipulative or abusive in nature?*

*If not, why not?*

AACHK: Agreed.

*Q9. Do you agree that an intermediary should establish minimum client requirements for its DMA services and assess whether each client meets the requirements before granting DMA services to a client?*

*If not, why not?*

AACHK: AACHK believes that it would be appropriate for the Commission to define what the minimum client requirements would be.

*Q10. Do you agree that an intermediary should not allow its client to sub-delegate the DMA services to another person unless the client is a licensed or registered person or an overseas securities or futures dealer? Do you agree with the proposed definition of "overseas securities or futures dealer"?*

*If not, why not?*

AACHK: No response.

*Q11. Do you agree that an intermediary should establish and implement effective policies and procedures to reasonably ensure that persons involved in the design and development of, or approved to use its algorithmic trading system and trading algorithms are suitably qualified?*

*If not, why not?*

AACHK: AACHK requests further definition of "suitably qualified".

*Q12. Do you agree that an intermediary should ensure that the algorithmic trading system and trading algorithms it uses or provides to clients for use are adequately tested to ensure that they operate as designed at all times?*

*If not, why not?*

AACHK: Agreed, however the HKEx should update and supply a satisfactory test system/ and test market in order to effectively test algorithms.

As mentioned in point 1. of the introduction above, AACHK believes that an implementation of effective pre-trade risk measures would mean that in depth source code knowledge of an algorithm should not be required. Instead, effective due diligence on what an algorithm does and how it is supposed to work should be a requirement.

*Q13. Do you agree that an intermediary should have effective controls to ensure the integrity of its algorithmic trading system and trading algorithms and that they operate in the interest of the integrity of the market?*

*If yes, are the proposed requirements for risk management sufficient? If not, why not?*

AACHK: Again, pre-trade controls should cover this requirement, however, as mentioned in our response to Q2 above, it would be virtually impossible for AACHK to determine whether its clients are trading with improper intent or negligence.

This being the case, AACHK believes that the wording should be modified to include "to an extent reasonable and practicable with the information available".

*Q14. Do you agree that an intermediary should keep, or cause to be kept, proper records on the design, development, deployment and operation of its algorithmic trading system and trading algorithms?*

*If not, why not?*

AACHK: AACHK does agree that records be kept on trading systems to a "reasonable" level. We would prescribe this to be keeping records on testing, conformance and material changes to the trading system.

*Q15. Do you agree with the proposed periods of record keeping and details of the records to be kept?*

*If not, why not?*

AACHK: AACHK allows clients who meet its own strict criteria as well as the SFC 's Professional Investor criteria, to trade under its memberships. AACHK's criteria include strict due-diligence requirements and also the implementation of certain pre-trade risk settings and controls. Our clients are third party professional trading groups who establish their own trading strategies and utilize algorithms to carry these strategies out. The algorithms are the clients own Intellectual Property and as such, our clients are incredibly careful about passing on that knowledge.

We believe that conformance to this requirement would be an issue for any intermediary who provides an algorithmic trading platform to its clients, not just AACHK.

*Q16. Do you agree that where an electronic trading system is provided by third party service provider, an intermediary should perform appropriate due diligence to ensure that the intermediary meets the proposed requirements set out in paragraph 18 of and Schedule 7 to the Code of Conduct in its use of the system?*

*If not, why not?*

AACHK: As mentioned in our response to Q3 above, we believe that a strengthening of levels and process of conformance testing by the HKEx should be implemented in order to ensure that the proposed requirements are met.

*Q17. What is your view on requiring an intermediary to make arrangements with a service provide for the purpose of meeting the proposed requirements*



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*on record keeping?*

AACHK: We would not engage a service provider who is unable to meet the pre-determined criteria.

Yours faithfully,  
For and on behalf of  
ABN AMRO Clearing Hong Kong Limited

A handwritten signature in black ink, appearing to be 'David West', written over a horizontal line.

David West  
Managing Director